

## Message Text

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INFORM CONSULS

E.O. 11652:N/A

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SUBJECT:CURRENT ECONOMIC DEVELOPMENTS: U.S. BALANCE OF  
PAYMENTS DEVELOPMENTS

1. THIS CABLE INITIATES PERIODIC REPORTS ON SIGNIFICANT  
ECONOMIC DEVELOPMENTS. IT REPLACES THE DEPARTMENT'S  
BIWEEKLY PUBLICATION "CURRENT ECONOMIC DEVELOPMENTS"  
WHICH HAS BEEN DISCONTINUED. THE CABLES IN THIS SERIES  
WILL BE SENT AT APPROXIMATELY FORTNIGHTLY INTERVALS, WILL  
CONCENTRATE ON ONE SUBJECT PER ISSUE, AND WILL BE SLUGGED  
"CURRENT ECONOMIC DEVELOPMENTS:" FOLLOWED BY THE  
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PARTICULAR SUBJECT COVERED IN THE CABLE. THE PURPOSE OF  
THESE REPORTS IS TO PROVIDE BACKGROUND INFORMATION TO  
OFFICERS IN THE FIELD.

2. SUMMARY. HIGHER OIL PRICES HAVE HAD MAJOR IMPACT ON U.S. BALANCE OF PAYMENTS. THEY HAVE AFFECTED MERCHANDISE TRADE, INVESTMENT INCOME AND CAPITAL TRANSACTIONS. ALONG WITH FLEXIBLE EXCHANGE RATES, HIGHER PETROLEUM PRICES AND CAPITAL FLOWS ASSOCIATED WITH THEM HAVE CONSIDERABLY DIMINISHED MEANING OF BROADEST TRADITIONAL MEASURES OF THE U.S. BALANCE OF PAYMENTS: THE NET LIQUIDITY AND OFFICIAL RESERVE TRANSACTIONS BALANCES. EB PREPARED THIS REPORT ON THE BASIS OF STATISTICS FOR FIRST HALF 1974 IN

SEPTEMBER ISSUE OF COMMERCE DEPARTMENT'S "SURVEY OF CURRENT BUSINESS". ESTIMATES FOR SECOND HALF 1974 HAVE NOT BEEN CLEARED WITH OTHER AGENCIES AND ARE FOR POSTS' INFORMATION ONLY. END SUMMARY

3. KEY ACCOUNTS OF THE U.S. BALANCE OF PAYMENTS FOR 1973-74 ARE SHOWN BELOW:

U.S. BALANCE OF PAYMENTS  
(U.S. DOLS BILLIONS, SEASONALLY ADJUSTED)

BALANCE ON:      1973 I   1973 II   1974 I   1974 II

MERCHANDISE TRADE   -1.3   1.8   -1.7   -5.1

GOODS AND SERVICES   -0.1   4.5   2.8   -2.5

CURRENT ACCOUNT   -1.9   2.4   -2.0   -4.5

LONG-TERM CAPITAL

ACCOUNT           -0.3   -1.1   1.0   NA

CURRENT ACCOUNT AND

LONG-TERM CAPITAL

ACCOUNT           -2.2   1.3   -1.0   NA

SHORT-TERM CAPITAL

ACCOUNT           5.2   -1.9   -1.6   NA

CHANGE IN U.S.

RESERVES           0.2   0   -0.6   NA

ERRORS AND OMISSIONS   -3.2   0.6   3.2   NA

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4. MERCHANDISE TRADE BALANCE. PETROLEUM IMPORT PRICES ALMOST TRIPLED IN FIRST HALF 1974. VOLUME OF THESE IMPORTS DECLINED BY ABOUT 10 PERCENT, LARGELY BECAUSE OF THE CONTINUED EMBARGO IN THE EARLY MONTHS. THE TRADE DEFICIT IN PETROLEUM PRODUCTS INCREASED TO DOLS. 11.3 BILLION BUT NON-PETROLEUM TRADE WAS IN SURPLUS BY DOLS. 9.6 BILLION. THE TOTAL MERCHANDISE TRADE DEFICIT FOR FIRST SEMESTER 1974 WAS DOLS. 1.7 BILLION. THIS SHARP DETERIORATION CONTRASTS WITH THE MARKED IMPROVEMENT IN U.S. MERCHANDISE TRADE ACCOUNT WHICH SEEMED TO BE THE TREND OVER COURSE OF LAST YEAR.

5. GEOGRAPHICALLY, TRADE WITH THE "DEVELOPING COUNTRIES OF ASIA AND AFRICA" ACCOUNTED FOR THREE-FOURTHS OF ADVERSE SHIFT IN OVERALL TRADE BALANCE IN FIRST SIX MONTHS 1974 AND THIS WAS DUE LARGELY TO INCREASED VALUE OF PETROLEUM IMPORTS. TRADE BALANCE WITH "LATIN AMERICAN REPUBLICS AND OTHER WESTERN HEMISPHERE" SHIFTED FROM A SURPLUS OF DOLS. 0.3 BILLION IN SECOND HALF OF LAST YEAR TO DEFICIT OF DOLS. 1.5 BILLION IN FIRST HALF 1974. THIS SHIFT WAS ALSO DUE LARGELY TO PETROLEUM. IN OTHER BILATERAL DEVELOPMENTS, TRADE DEFICIT WITH JAPAN

INCREASED TO DOLS. 623 MILLION DURING SAME PERIOD. BILATERAL TRADE DEFICIT WITH CANADA DECREASED TO DOLS. 490 MILLION. SURPLUS WITH WESTERN EUROPE ROSE TO DOLS. 2.3 BILLION.

6. BALANCE ON GOODS AND SERVICES. NET INVESTMENT INCOME RECEIPTS WERE DOLS. 4.9 BILLION IN FIRST HALF 1974. INCOME RECEIPTS ON U.S. DIRECT INVESTMENT ABROAD ROSE TO DOLS. 9.1 BILLION, OF WHICH INCOME FROM FOREIGN AFFILIATES OF U.S. PETROLEUM COMPANIES ACCOUNTED FOR NEARLY DOLS. 6.0 BILLION. INCOME PAYMENTS ON FOREIGN DIRECT INVESTMENT IN THE U.S. ALSO INCREASED. MOST OF INCREASE WAS DUE TO INCREASED INCOME PAYMENTS DUE TO A PETROLEUM-EXPORTING COUNTRY ON ITS PARTICIPATION IN A U.S. PETROLEUM COMPANY.

7. OVERALL, PETROLEUM TRANSACTIONS ON BOTH TRADE AND SERVICES ACCOUNTS HAD AN ADVERSE EFFECT OF DOLS. 7.8 BILLION ON THE GOODS AND SERVICES BALANCE FOR FIRST SIX LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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MONTHS OF YEAR. THE SURPLUS ON OTHER GOODS AND SERVICES TOTALLED DOLS. 10.6 BILLION. THE RESULT WAS A DOLS. 2.8 BILLION SURPLUS FOR ALL GOODS AND SERVICES, A DECLINE FROM THE DOLS. 4.5 BILLION SURPLUS IN SECOND HALF 1973.

8. CURRENT ACCOUNT. CURRENT ACCOUNT REFLECTS THE GOODS AND SERVICES BALANCE PLUS NET REMITTANCES, PENSIONS, AND OTHER TRANSFERS, AS WELL AS U.S. GOVERNMENT GRANTS. FIRST HALF 1974 DEFICIT OF DOLS. 2 BILLION, FOR EXAMPLE, REFLECTS SPECIAL DOLS. 2 BILLION RUPEE TRANSACTION WITH INDIA AND DOLS. 600 MILLION MILITARY GRANT TO ISRAEL AS WELL AS DOLS. 200 MILLION PIASTER TRANSACTION WITH VIETNAM, WITHOUT WHICH CURRENT ACCOUNT WOULD HAVE BEEN IN SURPLUS BY DOLS. 0.7 BILLION.

9. CURRENT ACCOUNT AND LONG-TERM CAPITAL ACCOUNT. REFERRED TO AS THE "BASIC BALANCE", THIS ACCOUNT REFLECTS THE SUM OF THE CURRENT ACCOUNT AND LONG-TERM CAPITAL MOVEMENTS. IT HAS BEEN CONSIDERED BY SOME AS AN INDICATOR OF THE UNDERLYING U.S. BALANCE OF PAYMENTS SITUATION. IN

FIRST HALF 1974, THIS ACCOUNT WAS IN DEFICIT BY DOLS. 1 BILLION, AS COMPARED WITH A SURPLUS OF DOLS. 1.3 BILLION IN SECOND HALF 1973. AS GENERAL PRINCIPLE OF BALANCE OF PAYMENTS ACCOUNTING, THE BASIC BALANCE MUST BE OFFSET BY AN EQUAL AMOUNT OF NET SHORT-TERM CAPITAL AND US RESERVE TRANSACTIONS IN OPPOSITE DIRECTION, EXCEPT FOR ERRORS AND OMISSIONS.

10. CAPITAL TRANSACTIONS. U.S. OUTFLOWS FOR DIRECT INVESTMENT ABROAD TOTALLED DOLS. 2.2 BILLION IN FIRST HALF 1974, LITTLE CHANGED FROM SECOND HALF 1973. THE

COMPOSITION OF U.S. DIRECT INVESTMENT FLOWS, HOWEVER, WAS SHARPLY AFFECTED BY INTERCOMPANY CAPITAL TRANSACTIONS BETWEEN PETROLEUM-PRODUCING AFFILIATES AND THEIR U.S. PARENT COMPANIES. (THESE TRANSACTIONS ARE COVERED FOR BALANCE OF PAYMENTS PURPOSES UNDER "U.S. DIRECT INVEST-

MENT ABROAD") DURING FIRST HALF 1974, FOREIGN DIRECT INVESTMENT INFLOWS INTO THE U.S. TOTALLED DOLS. 2.8 BILLION, COMPARED WITH DOLS. 2.5 BILLION FOR ALL OF 1973. LIMITED OFFICIAL USE  
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ABOUT THREE-QUARTERS OF THE INFLOW WAS ACCOUNTED FOR BY AN INCREASE IN THE AMOUNT ASSUMED OWED TO AN AFFILIATED FOREIGNER BY A U.S.-INCORPORATED PETROLEUM COMPANY ON THE DIRECT INVESTMENT INTERCOMPANY ACCOUNT.

11. WITH REGARD TO PORTFOLIO INVESTMENT, NET TRANSACTIONS IN U.S. AND FOREIGN SECURITIES IN FIRST HALF 1974 WERE MORE OR LESS OFFSETTING, COMPARED WITH A NET INFLOW OF DOLS. 2.1 BILLION IN SECOND HALF 1973. COMBINED BANK AND NON-BANK OUTFLOWS IN FIRST HALF 1974 TOTALLED ALMOST DOLS. 1.4 BILLION, DOLS. 0.6 BILLION MORE THAN IN THE ENTIRE YEAR 1973.

12. SHORT-TERM PRIVATE CAPITAL OUTFLOWS TO FOREIGNERS REPORTED BY U.S. BANKS TOTALLED DOLS. 11.4 BILLION IN FIRST HALF 1974, MORE THAN DOUBLE THE AMOUNT FOR ALL 1973. THIS REFLECTS THE HEAVY BORROWING OF PETROLEUM-IMPORTING COUNTRIES.

13. THESE CAPITAL OUTFLOWS MADE IT POSSIBLE FOR FOREIGNERS TO BUILD UP THEIR HOLDINGS OF LIQUID DOLLAR ASSETS IN THE U.S. THE INCREASE IN THESE ASSETS (WHICH REPRESENT CAPITAL INFLOWS) IN THE FIRST HALF OF 1974 WAS DOLS. 11.1 BILLION, CONSIDERABLY MORE THAN THE DOLS. 8.9 BILLION INCREASE IN ALL OF 1973.

14. THE DOLS. 11.1 BILLION INCREASE INCLUDED DOLS. 4.0 BILLION ACCUMULATED BY FOREIGN OFFICIAL AGENCIES, OF

WHICH NEARLY ALL (DOLS. 3.8 BILLION) WAS ACCOUNTED FOR BY OIL EXPORTING COUNTRIES. THE REMAINING DOLS. 7.1 BILLION WAS LARGELY ACCUMULATED BY FOREIGN BANKS AND PROBABLY REFLECTS TO A CONSIDERABLE EXTENT THE RE-INVESTMENT OF FUNDS DEPOSITED THERE BY OIL EXPORTING COUNTRIES.

15. THESE CAPITAL FLOWS, MANY OF WHICH REFLECT BORROWING BY OIL IMPORTING COUNTRIES IN THE U.S. AND DEPOSITS IN THE U.S. BY OIL-EXPORTING COUNTRIES, DIMINISH THE MEANING OF SUCH BROAD BALANCE OF PAYMENTS MEASURES AS THE NET LIQUIDITY BALANCE AND THE OFFICIAL RESERVE TRANS-

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ACTIONS BALANCE. FOR EXAMPLE, AN INCREASE IN THE OFFICIAL RESERVES TRANSACTIONS DEFICIT MAY NOW REFLECT NOT SO MUCH PRESSURE ON THE DOLLAR (THE INTERPRETATION UNDER FIXED EXCHANGE RATES) AS A DESIRE BY FOREIGN GOVERNMENTS TO INVEST SURPLUS REVENUES IN THE U.S. MONEY MARKET.

16. DISTINCTION BETWEEN LONG-TERM AND SHORT-TERM CAPITAL IS ALSO INCREASINGLY MISLEADING SINCE ALL TRANSACTIONS BETWEEN U.S. COMPANIES AND THEIR FOREIGN AFFILIATES ARE INCLUDED IN DIRECT INVESTMENT AND THUS IN THE LONG-TERM CAPITAL ACCOUNT, ALTHOUGH MANY OF THESE TRANSACTIONS WOULD BE CONSIDERED SHORT-TERM IF THEY WERE BETWEEN UNAFFILIATED PARTIES.

17. OUTLOOK. PROJECTING FORWARD UNDER PRESENT CIRCUMSTANCES IS DIFFICULT. WE HAVE PUT FORWARD SOME PRELIMINARY ESTIMATES FOR SECOND HALF 1974 IN THE ABOVE TABLE, ALTHOUGH OFFICIAL THIRD QUARTER STATISTICS ARE NOT YET AVAILABLE. OUTLOOK FOR 1975 WILL DEPEND ON VARIETY OF FACTORS, INCLUDING ESPECIALLY PRICE AND VOLUME OF IMPORTED OIL, PRICE AND VOLUME OF U.S. AGRICULTURAL EXPORTS AND IMPORTS, AND LEVEL OF AGGREGATE DEMAND IN U.S. RELATIVE TO THAT IN FOREIGN MARKETS. TREND AT THE MOMENT SEEMS TO BE DEFINITELY TOWARD WORSENING TRADE AND CURRENT ACCOUNT BALANCES IN 1975. INTERNATIONAL CAPITAL FLOWS RESULTING FROM PETROLEUM-RELATED TRANSACTIONS WILL BE A MAJOR INFLUENCE ON MOVEMENTS OF CAPITAL. THESE MOVEMENTS WILL BE GREATLY INFLUENCED BY THE ABILITY OF OIL IMPORTING COUNTRIES TO BORROW FUNDS TO MEET THEIR OIL BILLS, AND BY THE INVESTMENTS OF THE EXCESS OF INCOMES OVER EXPENDITURES BY THE OIL EXPORTING COUNTRIES.  
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